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The Goldman Guide

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Key Takeaways

- ⇒ We hope the market keeps dropping
- ⇒ Stats show panic which are precursors to rallies
- ⇒ Don't follow the herd or you'll get hurt
- ⇒ Buy growth stocks with reasonable valuations, not high-flyers
- ⇒ Buy mega caps, trade small caps

The Beginning of the End, or the End of the Beginning?

Someone needs to tell the industry pundits that perception is not reality. Moreover, someone needs tell the pundits to stop believing their own hype and that they are supposed to be the source of news and ideas, not the features themselves.

It is great to be a doomsayer because it will get you publicity and you can throw out some statistics that are manipulated to back into your thesis. It is relatively easy to do because even a moron knows the economy sucks, yet the market edges higher. It is even easier to be the doomsayer on the 25th anniversary of the 1987 Black Monday, when the Dow dropped more than 23%!

That is what happened all over the place on Friday. Let's use some critical thinking to review why it happened and how it impacts the future, because that is why we invest, after all. Some of the economy's biggest and most important companies reported financial results that were either below expectations, or somehow disappointed investors. Combine that with some options expiration and you have a huge 2% drop in the NASDAQ market.

Some are panicking and wringing their hands. Me? I am ecstatic.

(cont'd)

The Beginning....(cont'd)

By now, you all know Google (NASDAQ—GOOG), IBM (NYSE—IBM), McDonald's (NYSE—MCD), Microsoft (NASDAQ– MSFT) and GE (NYSE—GE) were the culprits, with doomsday prognostications aplenty. ***Please.***

Google has not achieved meaningful growth in mobile advertising so all of a sudden it is Facebook, which has not idea how to monetize mobile and is ever so slowly being marginalized in popularity? Something tells me the company behind the Android mobile platform will figure it out. Maybe they won't make as much $ or dominate mobile as they did the web, or maybe it is just a different animal? Either way, there is no reason to be chicken little.

Look, I recognize that when a company misses on top-line (which most of these companies did) as well as earnings, that does not bode well, especially in the face of low expectations to begin with. Still, this is par for the course this time of year.

We have panic again in the market. The VIX index measure of volatility is at new recent highs. The AAII Investor Sentiment Survey, which we like to cite as a negative barometer, turned very bearish, as it did in the summer before a mini-rally began.

When we have more bears and volatility and big declines, it creates opportunity, which is what we have been preaching will occur in the coming weeks. So, thank you all of you doomsayers. Please keep it up. Valuations are not out of control and you are making stocks cheaper.

In our view, it is not the beginning of the end, considering companies still are sitting on piles of cash. It may be the end of the beginning of this cycle's market is going to crash phase, as the market should be markedly higher by the end of 1Q13.

Key Statistics

Index	Close	YTD
DJIA	13344	9.2%
S&P 500	1428	13.6%
NASDAQ	3006	15.3%
Russell 2K	821	10.9%

(figures are rounded)

The Herd Mentality Will Always Cost You

It is hard for me to really let investors know when we believe in one stock over another. After all, text cannot truly gauge sentiment or tone, even if the words are as plain as can be. It is even harder when I make a prognostication early in a cycle and it takes a while to hit home. When it does, I like to remind folks not that we were right. I am not so vain. Instead, what is important as to why we were right so as not to make the typical mistake.

Case in point: Chipotle (NYSE—CMG). Exactly a year ago, we gave out some casual dining picks. We specifically noted that CMG which traded 100 points higher than its close last week, was way too pricey (valuation-wise) and that its growth was unsustainable. Instead, we recommended Panera Bread (NASDAQ—PNRA) and Red Robin (NASDAQ—RRGB), which had much lower valuations and growth rates nearly equivalent to CMG.

Panera is up 50% and RRGB is up 20%, though it was even higher. CMG was a leader—-of the herd. We all should know not to follow the herd. It is always better to buy a stock that is trading at a lower valuation but exhibiting similar characteristics as the herd leader. You will likely make more money with lower risk.

One small caveat to this strategy and philosophy is that in a pure trading environment, such as the current phase, it is wise to follow those stocks making new highs and flowing those coattails, for at least a spell. Even these situations tend not to be long-lasting, however, so be cautious.

If you have a taste for the big caps, or mega-caps, buy those stocks that had a bad week but are still on solid ground and trade the liquid, small caps reaching new highs. Even small gains are compounded into large ones.

Until next week...

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Rob Goldman founded Goldman Small Cap Research (GSCR) in 2009. Rob has over 20 years of investment and research experience as a senior research analyst and as a portfolio and mutual fund manager. During his tenure as a sell-side analyst, he was a senior member of Piper Jaffray's Technology team. Prior to joining Piper, Rob led Josephthal & Co.'s Emerging Growth Research Group. Rob has also served as Chief Investment Officer of two boutique investment management firms, where he managed Small Cap Growth and Balanced portfolios and *The Blue and White Fund.* As an investment manager, Rob's model portfolio was once ranked the 4th best small cap growth performer in the U.S. by *Money Manager Review*. In addition to his work at GSCR, Rob is the editor of Penny Stock Junction (www.pennystockjunction.com.)

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